MORTGAGE BANKERS ASSOCIATION
Investing in communities

August 15, 2007

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

RE: Home Ownership and Equity Protection Act Hearing and Request for Comments; Board Docket Number OP-1288 (72 Fed. Reg. 30380 [May 31, 2007])

The Mortgage Bankers Association[1] (MBA) appreciates the opportunity to submit comments in response to the Federal Reserve Board (the Board) as it reviews certain mortgage lending practices and terms. Specifically, this comment letter will address the use of the Board's unfair and deceptive acts or practices (UDAP) authority under section 129(l) of the Home Ownership and Equity Protection Act (HOEPA)[2] to address concerns related to prepayment penalties, escrows, stated-income and low-documentation loans and ability to repay standards. We applaud the Board's review of these issues through this comment opportunity as well as its June 14th hearing where a broad spectrum of stakeholders was able to share their views.[3]

While we applaud the Board's efforts to address abuses in the mortgage market, we are concerned about the possibility of an overbroad use of its authority under section 129(l) of HOEPA because of the extensive liability it could create for mortgage lenders, resulting in increased costs to consumers. For this reason, MBA encourages the Board to use this authority surgically, in a targeted manner to address those acts or practices which are unequivocally unfair or deceptive. Overbroad use of section 129(l) could have a deleterious effect on the availability of affordable mortgage credit and expose lenders to extraordinary liabilities that far exceed the damage incurred because of a

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the Nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field.

[2] 15 U.S.C. § 1639(1)(2)

[3] 75 Fed. Reg. 30380 (May 31, 2007)

compliance failure. Investors will not invest in and lenders will not make mortgage loans they fear will expose them to significant or unquantifiable liability exposure. This will have a dramatic impact on access to mortgage finance – particularly for subprime borrowers, many of whom represent a traditionally underserved population of low- and moderate-income and/or credit impaired individuals. In addition, any approach taken by the Board should take into consideration its possible effects on the existing credit crunch. At present, much of the mortgage market is illiquid and MBA is concerned that an overbroad approach could exacerbate that problem. Further, in developing any new provisions, MBA strongly encourages the Board to rely on the standards for unfair and deceptive that it set out in its 2004 guidance.[4]

We also believe that it is unnecessary to extend new standards under this authority to all market sectors and to all loans. Rather, any new standards should apply to a category of loans deserving of greater protections. Determining which loans qualify in this category should be defined by objective and clearly defined standards.

Where the Board concludes that new or improved disclosures are the right approach to address lending concerns, we would encourage the Board to use its authority under section 105(a) of the Truth in Lending Act (TILA) to promulgate such disclosures. Further, where the Board recognizes the need for lenders to have greater flexibility in developing new and innovative products or taking unique borrower circumstances into consideration, we would recommend any new requirements be issued as guidance.

In the process of undertaking any further regulatory action, the Board should anticipate that the market will fully react to and embrace the Final Statement on Subprime Mortgage Lending ("Statement").[5] The Statement will have a significant and broad impact on mortgage lending beyond the subprime market, as has already occurred with the Nontraditional Mortgage Product Guidance ("Guidance").[6] Since that guidance was finalized, it also has been instituted by approximately 35 states and is being incorporated into the lending practices of many national and regional lenders. Several state-regulated national lenders have incorporated the Guidance as their lending standard in all 50 states – well beyond what is required of them. We anticipate that the Statement will have the same effect.[7]

As an overarching principle reflecting MBA's view of the mortgage market, we cannot underscore enough the importance of allowing lenders to be innovative and flexible as appropriate. The market has already reacted severely to current financial, economic and political conditions by tightening credit standards. Policymakers are now

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[4] Board of Governors of the Federal Reserve System & Federal Deposit Insurance Corporation, *Unfair or Deceptive Acts or Practices by State-Chartered Banks* (Mar. 11, 2004) (hereinafter "UDAP Guidance").

[5] 72 Fed. Reg. 37569 (July 10, 2007)

[6] 71 Fed. Reg. 58609 (October 4, 2006)

[7] N.B. MBA remains concerned that as States embrace the principles of the Statement it will create disparate standards that will result in compliance difficulties.

responding and we encourage the Board to take a balanced approach in devising new regulations so that the cure is not worse than the disease. We are extremely concerned that the availability of mortgage credit will continue to tighten in the coming weeks and months and we want to be able to serve consumers and homeowners who are in need of mortgage finance.

Before we provide specific comments in response to the Board's request for further information related to prepayment penalties, escrows, stated-income and low-documentation loans and ability to repay standards, we have provided data reflecting the current state of the mortgage market. This section provides context for the comments that follow.

I. THE STATE OF THE MORTGAGE MARKET

As indicated, the impact of the existing credit crunch in the mortgage market on current and potential homebuyers is a stark reality. While the past few years have brought significant gains in homeownership with very liquid markets and record low costs of mortgage credit, the current credit crunch threatens these successes. Our members indicate that there is a dramatic, almost violent, reduction in the availability of capital market take-out for many types of mortgages – this situation threatens not only subprime financing but prime financing as well.

While the current market is changing daily, many Americans have thrived from homeownership over the past few years. Homeownership today is near its highest level in history – nearly 70 percent overall. Homeownership rates rose roughly 3.5 percentage points in the U.S. between 1989 and 2001. Looking at recent years, in 2001, the overall homeownership rate was 67.8 percent. In 2006, it was 68.9 percent. For African-Americans, the rate in 2001 was 47.7 percent, and in 2006 it grew to 48.2 percent (although it was 49.1 percent in 2004). For Hispanics, the rate in 2001 was 47.3 percent and in 2006 it was 49.5 percent. As a result of these increases in homeownership, across all demographics, more Americans are building tremendous wealth by increasing their home equity through their monthly payments and through the impressive rate of home price appreciation seen in recent years.

MBA's data indicate that more than a third of all homeowners own their homes free and clear of any lien. Of the 50 million, or two-thirds of homeowners, who do have mortgages, three-quarters have fixed rate loans. Only one quarter of these borrowers, or about a sixth of all homeowners, have adjustable rate mortgages (ARMs).

Homeowning Household Distribution
By Mortgage Type

Household Mortgage Type	Percent	Percent of Those with a Mortgage
No Mortgage	**34.6**	
Fixed Rate	49.2	75.2
Adjustable Rate	**16.2**	**24.8**
Jumbo	.3.9	6.0
Conforming	12.3	18.8
Total	**100.0**	**100.0**

Source: American Housing Survey; Mortgage Bankers Association

According to MBA's Mortgage Originations Survey, in the second half of 2006, 12 to 15 percent of subprime loans were used by first-time homebuyers. Almost three-fourths, or 72 percent, of subprime originations were originated by mortgage brokers in the second half of 2006. For this same period, nearly half of subprime borrowers, or 47 percent, used subprime loans to buy homes – up 2 percent from the first half of 2006.

II. SUBPRIME MARKET TROUBLES IN PERSPECTIVE

Among current homeowners, 4.9 percent are subprime borrowers with adjustable rate mortgages. Of these subprime ARMs, 10.13 percent are seriously delinquent or in foreclosure. To put this in proper perspective, this is 10 percent of 4.9 percent of homeowners with mortgages, or approximately 250,000 homeowners. Considering historic rates of foreclosure, these statistics, while important, are not out of line with rates in the past and do not alone characterize a macroeconomic event for the U.S. economy.

Notably, the problems associated with the subprime market were driven by a number of factors: over-capacity of capital, deceleration or drop in home-price appreciation and an increase in unemployment in specific regions in the country. The issue of over-capacity is being addressed both by market participants who are tightening underwriting standards or have left the market altogether and by federal regulators. For example, today the percentage of banks reporting tighter underwriting standards is the highest in 15 years.

Additionally, regulatory actions such as the new, comprehensive guidance related to nontraditional products and the final statement on subprime lending, as well as market corrections, have tightened the underwriting of many mortgage products. At the same time, borrowers are experiencing significantly increased difficultly in qualifying for mortgage credit compared to just a few months ago.

Further, former Federal Reserve Governor Gramlich offers information about the causes for delinquency in the subprime mortgage market in his book *Subprime Mortgage,* *America's Latest Boom and Bust*.[8] He cites data from the Home Ownership Preservation Initiative (HOPI)[9] which indicates that the two biggest factors noted by borrowers as being at least one of the reasons driving their foreclosures are job loss, accounting for 47 percent, and medical problems, accounting for 28 percent.

An examination of MBA's National Delinquency Survey (NDS) for the first quarter of 2007 also confirms the causal relationship between unemployment and delinquencies. For example, the chart below shows the top five states that have the highest delinquencies across all loan categories (including subprime ARM, subprime fixed, FHA, prime ARM and prime fixed), which include three that also have the highest rates of unemployment – Ohio, Michigan, and Indiana.

Seriously Delinquent Loans - 2007 Q1

Subprime ARM		**Subprime Fixed**		**FHA**		**Prime ARM**		**Prime Fixed**		**All Loans**	
HIGHEST FIVE STATES											
Ohio	19.86	Mississippi	14.06	Michigan	10.01	Mississippi	4.77	Ohio	1.92	Ohio	5.14
Michigan	18.98	Ohio	12.70	Ohio	8.72	Indiana	4.16	Louisiana	1.75	Mississippi	4.52
Louisiana	18.27	Louisiana	11.48	Louisiana	7.82	Ohio	4.10	Indiana	1.67	Indiana	4.51
Mississippi	17.93	Michigan	10.51	Indiana	7.58	Oklahoma	4.01	Mississippi	1.65	Louisiana	4.23
Indiana	17.26	Indiana	9.90	South Carolina	7.14	Louisiana	3.92	Michigan	1.21	Michigan	4.16
US Average	**10.13**	**US Average**	**5.89**	**US Average**	**5.26**	**US Average**	**1.66**	**US Average**	**0.67**	**US Average**	2.23
California	7.57	California	2.92	California	1.96	California	1.22	California	0.20	California	1.36
LOWEST FIVE STATES											
Idaho	5.40	Utah	2.53	Idaho	1.91	Utah	0.77	California	0.20	Washington	0.88
Washington	4.72	Oregon	2.23	Montana	1.67	Oregon	0.67	Montana	0.19	Montana	0.80
Oregon	4.17	Hawaii	2.16	North Dakota	1.61	Hawaii	0.66	Hawaii	0.13	Oregon	0.79
Arizona	4.10	Arizona	2.07	Alaska	1.35	Washington	0.64	Wyoming	0.13	Hawaii	0.74
Utah	3.99	Alaska	1.38	Wyoming	1.22	Idaho	0.63	North Dakota	0.12	Wyoming	0.74

Seriously delinquent loans are those 90 days or more past due or in foreclosure
Source: Mortgage Bankers Association National Delinquency Survey

All three of these states have suffered large declines in manufacturing employment. While there has been some pickup in service sector employment in those states, that employment is not often in the areas where job losses occurred and the wages are often lower in the service sector. For example, while we have seen increases in employment in places like Cincinnati, Columbus, Ann Arbor and Indianapolis, we have seen job losses in Detroit, Flint, Cleveland, Dayton and Muncie.

[8] Edward M. Gramlich, Subprime Mortgage, America's Latest Boom and Bust, (The Urban Institute Press, 2007).

[9] HOPI, organized in 2003, refers to an organization in Chicago that educates consumers about the dangers of and ways to prevent foreclosure. HOPI has been integral in dropping the overall foreclosure rate in Chicago by 13 percent per year.

While Ohio, Indiana and Michigan account for 8.7 percent of the mortgage loans in the country, those three states account for 19.9 percent of the nation's loans in foreclosure and 15 percent of all of the foreclosures started in the country during the first quarter. Without these three states, the percent of loans in foreclosure in the U.S. would be below the average over the last 10 years, 1.12 percent versus an average of 1.19 percent.

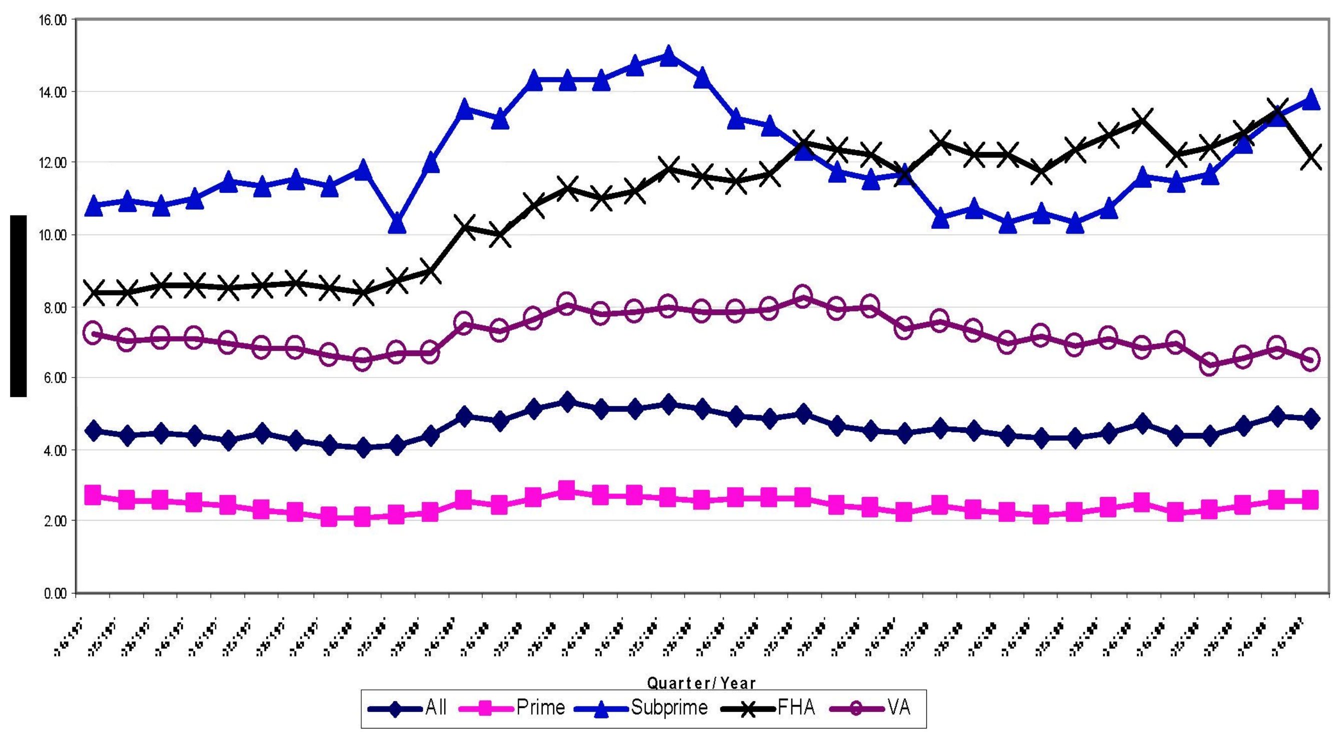
To put these numbers in further perspective, the level of foreclosures and foreclosure starts for those three states has exceeded what occurred in Texas during the oil bust of the mid-1980s, and Ohio is the highest ever seen in the MBA survey for a large state.

In its most recent data, MBA is seeing increases in delinquencies and foreclosures for subprime loans, particularly subprime ARMs. Because of technology, induced cost reduction and efficiency gains by the industry as well as the appetites of borrowers for credit, the share of outstanding loans that are subprime has been increasing for the last several years. Higher average delinquency and foreclosure rates among these loans mean the overall statistics for total outstanding mortgages are unlikely to fall as low as in the past.

It is important to note that subprime loans have always had higher delinquency and foreclosure rates and that lenders factor in these risks when lending to subprime borrowers. Given the fact that subprime borrowers have weaker credit profiles, this is not surprising. Foreclosures also can be accelerated by slow housing markets that limit borrowers' ability to quickly sell in order to cover their losses. MBA data has indicated that over the last several quarters a number of factors, including the aging of the portfolio, increasing short-term interest rates and high energy prices, also have been putting upward pressure on delinquency rates.

Notably, according to MBA's NDS, delinquencies overall dropped in the first quarter of 2007 from the fourth quarter of 2006. Assertions that delinquency rates are at crisis levels and a greater percentage of borrowers are losing their homes are not supported by data. In fact, delinquency and foreclosure rates have remained relatively low with increases over the last year. The chart below traces delinquencies from 1998 through the first quarter of 2007. It reveals the fact that delinquencies were significantly higher in the subprime market at the end of 2000, as well as during 2002, than they were in the first quarter of 2007.

Chart 1. Total Delinquency Rate by Loan Type



The delinquency rate for mortgage loans on one-to-four-unit residential properties stood at 4.84 percent of all loans outstanding in the first quarter of 2007 on a seasonally adjusted basis, down 11 basis points from the fourth quarter of 2006, and up 43 basis points from one year ago, according to MBA's NDS. Both prime and subprime ARM loans had higher delinquency rates as compared to the fourth quarter of 2006.[10]

MBA's first quarter 2007 NDS found that the percentage of loans in the foreclosure process was 1.28 percent, an increase of nine basis points from the fourth quarter of 2006, while the seasonally adjusted rate of loans entering the foreclosure process was 0.58 percent, four basis points higher than the previous quarter. The foreclosure inventory rate for subprime loans in the first quarter of 2007 was 5.10 percent, up from 4.53 percent in the fourth quarter of 2006. The foreclosure inventory rate for prime ARMs went from 0.92 percent in the fourth quarter up to 1.09 percent in the first quarter, and for nonprime ARMs from 5.62 percent to 6.46. The foreclosure inventory rate increased for subprime fixed rate mortgage loans, going from 3.19 percent to 3.29 percent.

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[10] These figures are based on MBA data. MBA defines "delinquency" as having one or more payments overdue. The loans in foreclosure are approximately a third of these numbers and the borrowers actually losing their homes are approximately a fourth of that group.

III. SUBSTANTIVE COMMENTS

MBA shares the Board's commitment to eradicating abusive lending practices in the mortgage market. At the same time, MBA believes that efforts to protect consumers should be carefully targeted and balanced so that such efforts do not have a detrimental impact on the availability and affordability of legitimate mortgage credit. We have serious concerns about the overbroad use of the Board's authority under section 129(l) of HOEPA because it gives rise to significant potential liability. The potential exposure under this authority is such that lenders will significantly limit loans that trigger its application and price this risk into loans that are made. If new standards under this authority restrict credit, these standards will exacerbate the existing credit crunch that borrowers are currently facing. For subprime borrowers, who are hit with economic challenges more than in other sectors, it could force them to sell their homes as a last resort to access needed credit. Beyond that, an overbroad application of new standards will make it difficult for prime, let alone subprime, first-time homebuyers to access affordable mortgage credit. We are fearful that the outcome of overbroad standards under section 129(l) of HOEPA would exacerbate an already difficult credit environment.

We believe there are several steps that can be taken to help consumers protect themselves in the mortgage process, including the passage of balanced legislation by Congress. We would also support the establishment of a uniform disclosure regime that is simple and clearly conveys loan terms. In addition, a robust financial literacy campaign would go a long way to educate consumers so that they are in a better position to negotiate a good deal in light of their situation and protect themselves from rogue players in the marketplace. Further, there should be a more aggressive pursuit of bad actors and enforcement should be increased to ensure existing laws are followed.

As noted earlier, we would encourage the Board to use this authority is a surgical manner. Where the Board determines a need to more clearly disclose information to consumers, we would encourage the Board to use its authority under section 105(a) of TILA to implement such requirements. And where the Board recognizes the benefits conferred on consumers because of lender innovation, discretion and flexibility, we would recommend that any new provisions be issued as guidance.

All new requirements should be prospective and allow lenders sufficient time to implement systems, train personal and fully comply.

We would also request that the Board work with the other banking regulators that plan to issue new standards for the market in order to assure uniformity to the maximum extent possible. Uniformity will lessen compliance costs, mitigate unnecessary liability and thereby reduce costs for borrowers.

A. The Board's Authority

The following examines the Board's authority under section 129(l) of HOEPA and section 105(a) of TILA to address mortgage lending practices.

1. Section 129(l) of HOEPA

The Board's authority under section 129(l)(2) states that the Board, by regulation or order, shall prohibit acts or practices in connection with (A) mortgage loans that the Board finds to be unfair, deceptive or designed to evade the provisions of this section, and (B) refinancing of mortgage loans that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower.

Although the scope of section 129 is not well defined, this authority has clear limitations. The Board may only address practices in connection with mortgage loans it deems "unfair" and "deceptive" or designed to evade HOEPA's requirements and to address refinance mortgage loans the Board deems abusive as set out under provisions (A) and (B) of section 129(l)(2).

a. 2004 Guidance on Unfair and Deceptive

HOEPA does not define standards for determining acts or practices that are unfair or deceptive. However, according to the legislative history of HOEPA,[11] in determining standards for "unfair" and "deceptive" the Board should look to state unfair and deceptive trade practices acts and the Federal Unfair and Deceptive Practices Act (15 U.S.C. §45(a)(1)). In 2004, the Board established standards for these terms in guidance issued with the Federal Deposit Insurance Corporation (FDIC).[12] Importantly, the Board recognized that determining whether an act or practice is unfair or deceptive often depends on the specific facts or circumstances involved. The Board also clarifies that the standards for determining "unfair" and "deceptive" are different. MBA would encourage the Board to rely on these standards if it decides to move ahead with rulemaking under section 129(l)(A) of HOEPA. These standards are further described below.

1. Guidance Standard for Unfair

The Guidance sets forth the following standards for determining an "unfair" practice and provides that all three elements should be met: An act or practice is unfair where it (1) causes or is likely to cause substantial injury to consumers, (2) cannot be reasonably avoided by consumers, and (3) is not outweighed by countervailing benefits to

[11] H.R. Rep. No. 103-652, (1994).

[12] Board of Governors of the Federal Reserve System & Federal Deposit Insurance Corporation, *Unfair or Deceptive Acts or Practices by State-Chartered Banks* (Mar. 11, 2004) (hereinafter "UDAP Guidance").

consumers or to competition. Public policy may also be considered in the analysis of whether a particular act or practice is unfair.

The guidance further provides additional interpretation about the meaning of these elements. Specifically, it states that "trivial or merely speculative harms are typically insufficient for a finding of substantial injury. Emotional impact and other more subjective types of harm will not ordinarily make a practice unfair."

The guidance clarifies that consumers cannot reasonably avoid injury from an act or practice if it interferes with their ability to effectively make decisions. Withholding material price information until after the consumer commits to purchase a product, for example, would qualify as preventing someone from making an informed choice. The Board also indicated that it will not second guess the wisdom of particular consumer decisions.

Further, the guidance states that for a practice or act to be unfair "it must be injurious in its net effects meaning that the injury cannot be outweighed by any offsetting consumer or competitive benefits that are also produced by the act or practice." The Board qualified lower prices or wider availability of products as examples of offsetting benefits.

The guidance also provides greater explanation about public policy considerations. It states, "[p]ublic policy, as established by statute, regulation, or judicial decisions may be considered with all other evidence in determining whether an act or practice is unfair. For example, the fact that a particular lending practice violates a state law or a banking regulation may be considered as evidence in determining whether the act or practice is unfair. Conversely, the fact that a particular practice is affirmatively allowed by statute may be considered as evidence that the practice is not unfair."

2. Guidance Standard for Deceptive – Representation, Omission or Practice

The guidance sets out the following standard for deceptive: A three-part test is used to determine whether a representation, omission or practice is "deceptive." First, the representation, omission or practice must mislead or be likely to mislead the consumer. Second, the consumer's interpretation of the representation, omission or practice must be reasonable under the circumstances. Third, the misleading representation, omission or practice must be material.

In determining whether an act or practice is misleading, the consumer's interpretation or reaction to the representation, omission or practice must be reasonable under the circumstances. The test for determining this is "whether a consumer's expectations or interpretation are reasonable in light of the claims made." The guidance indicates that a representation, omission, or practice is material "if it is likely to affect a consumer's decision regarding a product or service."

b. The Implications of "Materiality" Under Section 129

As indicated earlier, violations of section 129 give rise to greater liability than other violations of TILA requirements. Among the remedies under section 129 is the extended right of rescission. Remedies under 129 are only available when a failure to comply is "material." Under section 130(a)(4) of TILA, a creditor is liable for enhanced damages unless "the creditor demonstrates that the failure to comply is not material."

In addition, any failure to comply with a requirement adopted under section 129(l)(2) could qualify as an unfair or deceptive practice under state UDAP laws and subject a lender to the substantial additional damages provided by state laws.

Moreover, in the Board's 2004 guidance discussed earlier, it indicated that whether an act or practice is unfair or deceptive requires an individual evaluation and stated, "[w]hether an act or practice is unfair or deceptive will in each instance depend upon a careful analysis of the facts and circumstances." Because the analysis of whether there exists an unfair or deceptive act or practice requires a determination on a case-by-case basis, MBA believes that this analysis can only be made on an individual basis and not on a class-wide basis. Notwithstanding, MBA requests that in any action under these provisions, the Board make clear that "materiality" can only be made on a case-by-case basis.

2. Board's Authority Under Section 105(a) of TILA

In addition, the Board also has broad authority to require disclosures under section 105(a) of TILA.[13] It is under this authority that the Board issued its Consumer Handbook on Adjustable Rate Mortgages (the "CHARM" booklet). In this current undertaking, if the Board decides that disclosures will sufficiently address its concerns, we believe that the Board should use section 105(a) authority to issue the disclosures rather than section 129(l) of HOEPA.

B. Answers to Specific Questions

Prepayment Penalties

1. Should prepayment penalties be restricted? For example, should prepayment penalties that extend beyond the first adjustment period on an ARM be prohibited?

Prepayment fees, when properly used, offer consumers tremendous value in connection with a mortgage. They offer consumers the opportunity to lower their monthly payment or significantly reduce fees in exchange for not refinancing out of the loan for an agreed upon period of time.

[13] 15 U.S.C. §1604(a)

The Statement, which will have broad market effects, requires that prepayment penalties not extend beyond the reset period of subprime hybrid ARMs that have a short initial period and then adjust to the variable index rate plus a margin. It further provides that borrowers should be allowed a reasonable period of time (typically at least 60 days prior to payment reset) to refinance without a penalty. MBA believes the market will conform to this standard, allowing borrowers a period of up to 60 days prior to the initial payment reset to avoid payment of any prepayment fee, and alleviating the need for the Board to issue additional rules to address this concern.

MBA supports the limitation of prepayment fees to three years for all mortgage loans across all mortgage sectors. At the same time, we do not agree that prepayment fees that exceed three years are by their nature unfair or deceptive under the Board's standard set in the 2004 guidance. Prepayment fees beyond three years can offer consumers cost savings through a lower rate or lower costs, or make such financing available to a segment of the population. In addition, consumers have the option of rejecting such a loan term or product that contains such a loan term. Abuses arise where the existence of a prepayment fee is not disclosed to the consumer, making it difficult for them to make a well informed choice. Our response to question 2 lays out our position and recommendation on prepayment fee disclosures.

2. Would enhanced disclosure of prepayment penalties help address concerns about abuses?

Yes. MBA strongly supports improving and streamlining mortgage disclosures, including those that address prepayment fees, to simplify the information about the transaction and make the type and terms of the mortgage more transparent. MBA supports an approach to prepayment fees that offers consumers 1) notice, 2) benefit, and 3) choice. This disclosure would clearly remind and notify a consumer that they have opted for a prepayment fee, the cost savings or benefit of a prepayment fee and provide qualifying consumers a choice of a mortgage with a prepayment fee and one without (as long as the borrower qualified for a loan without a prepayment fee).

The Board could take the approach of requiring the delivery of the notice under section 129(l) of HOEPA and then use its authority under section 105(a) of TILA to stipulate the particular requirements of the notice along with providing a model disclosure to ensure clear and objective compliance.

MBA would support the use of 129(l) to require the provision of prepayment fee disclosures as long as such a requirement avoids unreasonable liability. MBA believes that lenders should be able to avoid unreasonable liability for a failure to make a prepayment fee disclosure, if the following conditions are met:

- Lenders have policies and procedures in place to ensure delivery of the prepayment fee notice. This prevents exposure to significant liability for unintended glitches like a computer system failure.

- Notice should be delivered within three business days after application. The delivery of the notice would be mandated after the consumer applies for a mortgage and selects a product. This notice should be provided at the same time as the required RESPA and early TILA disclosure, three business days after application. It would be provided to a consumer at a meaningful point in time when they are not locked in to the transaction and it would reflect the terms of the exact prepayment fee they have been offered – not something generic.
- There would be no liability unless it can be shown that a lender knowingly and intentionally failed to comply with the provision.

The foregoing approach benefits consumers with improved prepayment fee disclosures at a meaningful point in the transaction. It also creates clear compliance standards for lenders to follow.

3. How would a prohibition or restriction on prepayment penalties affect consumers and the type and terms of credit offered?

Prepayment fees benefit consumers by allowing them to lower their rate or reduce their fees in exchange for agreeing not to refinance out of the mortgage for a period of time. Across all sectors of the mortgage market, prepayment fees are available on a broad range of loans, permitting a borrower to lower the cost of their mortgage and enabling the investor to rely on the cash flow for the agreed upon period.

Prohibiting this feature or significantly restricting its use can be expected to increase rates to borrowers or take away financing options. The secondary market prices mortgage products based on a number of factors that affect the investor’s return. A prohibition or restriction on the use of prepayment fees will likely increase expected prepayment speeds for subprime mortgages. If subprime products refinance more quickly as a result of this Board’s decision, investors will demand a higher return. This will increase interest rates to borrowers and reduce investment in certain mortgage backed securities.

Escrow for Taxes and Insurance on Subprime Loans

The Board states that loans to prime borrowers typically require the establishment of escrow accounts for the payment of taxes and insurance, while loans to subprime borrowers typically do not. The Board further states that consumer advocates are concerned that subprime borrowers are not aware of, and may not be able to budget for, these expenses. Further it argues that some lenders are failing to include tax and insurance payments in their quotes of monthly mortgage payments to borrowers. The Board then asks a series of questions as to the appropriateness of disclosing additional information or mandating escrows, to which MBA responds as follows.

The purpose of an escrow account is to protect the lender’s priority lien position and to protect the collateral in the event of damage or destruction to a home. While the practice of escrowing provides a benefit for the consumer, by taking over the borrower’s responsibility for paying property taxes and insurance, these expenses are and always were the borrower's responsibility under its mortgage.

At the inception of the subprime market, many subprime servicers were not equipped to establish escrow accounts. Many of the entrants into this market came from the consumer finance and capital markets arenas which did not traditionally have the technology systems or people in place to establish and collect escrows. Recently, however, that paradigm has shifted. According to MBA's 2006 benchmarking studies, approximately 50 percent of all first lien subprime mortgages now are escrowed. That figure compares to 71 percent of prime loans that are escrowed. Subprime servicers indicate that the proportion of the accounts escrowed continues to grow.

In recent years, RESPA was amended to establish limits on amounts that could be held in escrow accounts for borrowers. These limitations grew from concerns that lenders gain from such accounts and borrowers should not be required to have them. Considering this recent history, MBA strongly asserts that escrowing or not escrowing cannot be viewed as predatory, unfair or deceptive. Further, the business decision not to escrow fails to meet the definition of unfair dealing, as set forth in the 2004 Board/FDIC guidance on unfair practices.

MBA believes, instead, that arming borrowers with the appropriate information about their obligations to pay taxes and insurance and including these items in the lender's underwriting of borrowers' creditworthiness provides the appropriate protections for consumers.

A. Additional Disclosures

1. MBA Position

As indicated, MBA believes that borrowers should be clearly informed of key provisions of their mortgage and payment obligations that are necessary to maintain the mortgaged property. Just as importantly, originators should not mislead a borrower into refinancing his or her loan by claiming that the borrower can reduce its monthly payment, when in fact the new loan does not include escrowed amounts, but the old loan does. Disclosing whether the loan will or will not have an escrow account for the borrower is important. MBA, therefore, supports providing the borrower with greater information at origination about their obligations to pay taxes and insurance and whether or not the loan has an escrow for these expenses. In accordance with, and in addition to, the escrow disclosures recommended in the recently announced Subprime Statement, MBA supports the following points in this area:

- Underwriting the borrower's housing expenses to include estimated taxes and insurance costs;

- Disclosing to the borrower whether or not an escrow account will be established for the payment of taxes and insurance for the property;

- Notifying borrowers, in instances where escrow accounts are not being established, of their responsibility to pay taxes, hazard insurance, as well as, flood insurance and mortgage insurance, as applicable, and the consequences of non-payment; and

- Providing non-escrowed borrowers with an estimate of required costs for hazard insurance, real estate taxes, flood insurance and mortgage insurance, as applicable, that were used to underwrite the borrower's mortgage. Such disclosure should, however, caution borrowers that such estimates are just that and borrowers should consult with appropriate authorities to confirm the specific amounts due.

The timing of these new disclosures should be consistent with what is required for escrowed loans under RESPA.

MBA believes that the above provisions would arm consumers with all necessary information to protect them from predatory lending regarding the costs of taxes and insurance and would obviate the need for mandatory escrows. Moreover, this information would allow borrowers to appropriately budget for these obligations. MBA recognizes the significant impact that the recent Subprime Statement will have in this area in that it encourages the establishment of escrows.

B. <u>Mandatory Escrows</u>

1. <u>Concerns</u>

MBA is concerned with mandating escrow accounts for borrowers. We believe a requirement to establish such accounts in the first instance treats borrowers as unable to take responsibility for their expenses. Mandatory escrows would also increase the amount of cash necessary for borrowers to close a loan, depriving some of homeownership or refinance opportunities. Beyond that, such mandates lock the servicer into a long-term commitment that, in turn, allows states and localities to impose costs and fees, including interest, remittance, duplicate bill and technology surcharges for remitting taxes. These costs can be high and eliminate significant value of the servicing asset. Mandating escrows would also increase compliance costs to lenders and borrowers as a result of conflicting laws. Any such requirements should not extend to second liens.

Generally, servicers consider escrows to be highly desirable because they enhance the value of the servicing asset. Value is eroded, however, when servicers are not able to control their costs. Because subprime (and the vast majority of prime) servicers today can control whether to escrow, they can resist unreasonable state and county governments' costs on the industry and ultimately its borrowers. If servicers are required to escrow and, therefore, bear *any* associated cost, lenders (and ultimately borrowers) will become targets for state and county revenue raising initiatives. This happens today and will certainly occur even more if the Board mandates escrows.

2. Management of Non-escrowed Accounts

Consumer advocacy groups argue that lenders that do not escrow are at a greater risk of loss of collateral and thus question why a subprime servicer would not demand an escrow account. Servicers, however, have developed alternative means of tracking delinquent taxes and lapsed insurance policies for non-escrowed loans that allow them to reduce their risk of loss. We would like to take this opportunity to describe in some detail the processes that servicers use to track non-payment of taxes and insurance policies to show that servicers, and in most cases borrowers, are protected even when the loan is not escrowed.

With regard to hazard and other peril insurance, servicers are designated as "loss payees" or "mortgagees" on all policies. Under the loss payee/mortgagee clause, the insurer is contractually obligated to notify the servicer if the policy lapses or is cancelled. Upon being notified, the lender will contact the borrower and request evidence of alternate insurance. If such evidence is not provided, the servicer may purchase a replacement policy, called a "lender-placed policy."[14] The borrower is given ample time to respond to the servicer's requests and to correct any problems before the lender purchases a "lender-placed policy." This is a fair and reasonable practice.

With regard to taxes, servicers usually outsource tax monitoring to specialized companies who obtain lists of delinquent real estate taxes from county representatives. These lists are then matched against the servicer's portfolio of non-escrowed loans serviced. If a match occurs, meaning a borrower is delinquent on his or her real estate taxes, the servicer will contact the borrower and may advance its own corporate funds to pay the tax.[15] Servicers work with each borrower to determine the best repayment options based on the individual's financial circumstances. Servicers often do not charge interest on such advances (loans), despite having the authority in most mortgage documents to do so.

3. Cost to Close

The Board seeks comment on the impact of escrowing on consumers. Escrowed loans require more cash to close than non-escrowed loans. As a result, were an escrow requirement imposed, some borrowers may find it difficult to raise the additional funds, lessening affordability and delaying if not depriving them of homeownership.

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[14] If the loan is scheduled for foreclosure, a servicer may not purchase a lender-placed policy to avoid increasing the borrower's debt and servicer's loss. This policy is consistent with RESPA, which does not require the advancing of funds if the borrower is 30 days or more delinquent.

[15] If the loan is scheduled for foreclosure and the property has no or negative value, a servicer might not advance for taxes and insurance. This policy is consistent with RESPA, which does not require the advancing of funds if the borrower is 30 days or more delinquent.

As you may be aware, servicers that escrow are subject to the Real Estate Settlement Procedures Act (RESPA). RESPA permits lenders to collect a two-month cushion of estimated escrow disbursements for the year using the aggregate accounting method.[16] The cushion is collected at closing when the loan is escrowed. In addition, RESPA permits the lender to collect escrows attributable to the period from the date such payments were last paid until the initial payment date. This means that borrowers have to provide sufficient additional cash at closing. Depending on timing, this can mean several months of taxes and insurance payments at closing. The practice of properly funding an escrow account at closing is critical to the servicer's safety and soundness and should not be altered or it would cause lenders to have to advance millions of additional dollars.

The increased cost to close problem also exists on a refinance. While the borrower will receive a refund of any escrow account already established with the old servicer, the new lender also requires tax payments to be collected at closing for the taxable period. There is no way to "offset" this expense when the servicer and originator are separate entities and thus the borrower is paying twice, albeit for a short time. The additional funds to close may also limit the borrower's ability to refinance.

We raise this issue to point out some of the nuances that might not have been contemplated by the Board staff and the ramifications of mandating escrows on both the borrower and the mortgage company.

4. Recommendations

MBA urges the Board not to mandate escrows but to provide borrowers with greater disclosure. However, if the Board does impose mandatory escrows, it should consider several important concepts:

First, any mandatory escrow policy should only be applied to closed-end first mortgages. Second lien holders do not escrow and their involvement in the escrow process would be confusing and almost impossible to coordinate with the first lien servicer. In some cases second mortgages are in first position simply because the homeowner has paid off the first mortgage, but taken out a home equity line of credit or closed-end second mortgage for personal, family or other purposes. These entities cannot be expected to have the capacity to escrow for a handful of clients. Some mechanism for excluding this category of creditor is critical.

Second, the Board and other agencies must clarify how servicers are to comply with both federal and state law. For example, in California, lenders are prohibited from establishing escrow accounts when the loan is below 90 percent loan to value (LTV) or

[16] 24 CFR 3500.17(b). The cushion is a necessity for the servicer to avoid having to advance its own funds to make the borrower's tax or insurance payments. Because tax assessments and insurance costs vary from year to year there is significant risk created by RESPA there will be insufficient funds in the borrowers escrow account if tax assessments and insurance premiums rise. The cushion helps reduce the chances that the servicer will have to advance its own funds.

below 80 percent LTV on all properties combined.[17] Would those laws be preempted given the federal government's pro-consumer mandate to maintain escrows?

Third, to the extent of its authority, the Board in combination with other regulators, should preempt state laws that are more restrictive than RESPA, such as states that further restrict escrow cushions to one month.

Fourth, it is important that the Board defines an "escrow item." Only real estate taxes, hazard insurance and, if required, flood insurance and mortgage insurance should be considered escrow items. No other third party fee should be considered an escrow item subject to mandatory collection and escrow. If the servicer, however, finds it prudent to escrow other items, such as condominium or homeowners association dues, because of particular risks in the locality, the servicer should have the authority to do so.

Fifth, mandatory escrows should not be applied retroactively. Retroactive application would result in repudiation of servicer contracts with borrowers. Given that many consumers favor managing their own taxes and insurance premiums, the change of existing contracts may not be a welcomed development. Prospective application would also allow servicers to price the loan for any inherent risk or additional resource and technology costs associated with any escrow mandate.

Last, to the extent the Board must act to mandate escrows, we would suggest limiting any escrow mandate to borrowers who demonstrate an inability to manage their tax and insurance obligations. Escrows should only be imposed after closing if the borrower fails to pay his or her taxes or insurance policies. This concept is similar to California state law that permits escrows on several conditions, including failure to pay tax bills.[18] While many servicers will mandate escrows at closing for the life of the loan as a business judgment, the Federal government's imposition of a mandate should be based on demonstrated problems. This will help keep costs to the servicer and the borrower in check. In the event the borrower does fail to meet his or her tax or insurance obligation, the servicer should still be given the right to cancel escrows in the future based on the borrower's subsequent good payment history or low loan-to-value ratio. The Homeowners Protection Act of 1998 could be used as a basis for determining good payment history. Under that law, the borrower demonstrates a good payment history, for purposes of dropping mortgage insurance, if he or she does not have more than one 60-day mortgage delinquency in the last two years and no more than one 30-day mortgage delinquency in the last 12 months. The servicer, not the borrower, should continue to control if certain escrows can be dropped. As is evidenced by the growing number of escrow accounts, servicers are favoring imposing escrows on both prime and subprime borrowers to manage risk of non-payment. Servicers should be permitted to protect their interest for the life of the loan. We oppose any mandatory elimination of an escrow account.

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[17] *Cal Civ Code § 2954* (Deering 2007)

[18] "upon a failure of the purchaser or borrower to pay two consecutive tax installments on the property prior to the delinquency date for such payments…" Id.

To the extent that such a mandatory policy is adopted and is subject to section 129(l) liability, we reiterate that such liability should only attach to the extent the servicer fails to have the policies and procedures in place to manage to the new regulatory requirement and the servicer's failure to require escrows is willful.

In addition, any mandatory escrow requirement should be imposed only after sufficient lead time is given to entities to develop the systems necessary to establish escrow accounts to process necessary payments and comply with RESPA's complicated escrow requirements.

"Stated Income" or "Low Doc" Loans

1. Should stated income or low doc loans be prohibited for certain loans, such as loans to subprime borrowers? Also, should stated income or low doc loans be prohibited for higher risk loans, for example, for loans with high loan-to-value ratios?

No. MBA believes reduced-documentation or stated-income loans can be beneficial and appropriate options for borrowers regardless of the type of loan or category of loan, whether it is prime, Alt. A, or subprime. There are various segments of our population who experience difficulty documenting their income and assets. Self-employed borrowers, for example, present lenders with the greatest challenges in determining their income as gross business receipts are often reflected on their tax returns, which is a common way to document income. The borrowers do not receive a W-2 that can easily confirm their earnings. Other borrowers do not have a means to document their assets, such as savings accounts, a situation common among recent immigrant borrowers.

MBA would not support a broad policy that assumes that a single underwriting standard like a particular loan–to-value ratio or debt-to-income ratio is a sufficient determinant of risk as to bar the use of stated-income and low-documentation loans across all mortgage market sectors and all loan programs. Such an approach is unnecessarily prescriptive and restrictive and will cut off legitimate credit.

Prohibiting stated-income or reduced-documentation loans to certain borrowers ought to be left to the lender, based on sound underwriting criteria, rather than establishing fixed criteria that will limit the availability of credit to some consumers. Underwriters analyze risk factors posed by individual borrowers when determining whether to offer them a stated-income or low-documentation loan. Underwriting criteria include the borrower's credit score, down payment, rent, utility, and other payment history as well as income, assets and liabilities which are evaluated to determine whether a stated-income or low-documentation loan is an appropriate option for the borrower.

The Subprime Statement limits the use of no-documentation and low-documentation loan features to instances where there are mitigating circumstances. In particular, the

Statement notes as examples circumstances such as repayment performance or substantial liquid reserves. MBA would again encourage the Board to anticipate a significant market impact as a result of this new standard which could offset the need to act further.

2. How would a restriction on stated income or low doc loans affect consumers and the type and terms of credit offered?

MBA strongly believes that limiting the availability of stated-income or reduced-documentation loans altogether would be unnecessarily harmful to many borrowers, including self-employed business persons, recent immigrants and others who have difficulty documenting their income or assets. If such a restriction were put into place, mortgage lenders may not be able to serve these and other groups.

3. Should lenders be required to disclose to the consumer that a stated income loan is being offered and allow the consumer the option to document income?

MBA recommends that where a borrower takes a stated-income loan, the Board should require that the originator provide a disclosure. Borrowers should also always be offered the option of documenting their income if they are in a position to do so. Any cost difference between a stated-income and fully documented loan should also be included in the disclosure.

The Board could take the approach of requiring the delivery of the notice under section 129(l) of HOEPA and then use its authority under section 105(a) of TILA to stipulate the particular elements of the notice, along with providing a model disclosure to ensure clear and objective compliance.

MBA would support the use of 129(l) to require stated-income loan disclosures as long as such a requirement avoids unreasonable liability. MBA believes that lenders should be able to avoid unreasonable liability for a failure to make a stated-income loan disclosure if the following conditions are met:

- Lenders have policies and procedures in place to ensure delivery of the stated-income notice. This prevents exposure to significant liability for unintended glitches like a computer system failure.
- Notice should be delivered three business days after application. The delivery of the notice would be mandated after the consumer applies for a mortgage and selects a product. This notice should be provided at the same time as the required RESPA and early TILA disclosure, three business days after application. It would be provided to a consumer at a meaningful point in time when they are not locked in to the transaction and it would reflect the terms and cost of their loan with a stated-income feature – not something generic.
- There would be no liability unless it can be shown that a lender knowingly and intentionally failed to comply with the provision.

The foregoing approach benefits consumers with improved stated-income disclosures at a meaningful point in the transaction. It also creates clear compliance standards for lenders to follow.

Unaffordable Loans – Determining Ability to Repay

Prudent underwriting is the cornerstone of responsible mortgage lending. Lenders have every incentive to properly underwrite a borrower's ability to repay a mortgage loan. In the event that loans fail, lenders may be forced to repurchase them, investors could decide to no longer do business with that lender and the lenders reputation could suffer. For these reasons, lenders take care in considering and evaluating a number of different factors when determining a consumer's ability to make their mortgage payments – across all market sectors. The Board addressed underwriting concerns in the Subprime Statement and Nontraditional Mortgage Product Guidance, which have had a significant impact on the market and underwriting standards.

The Board should use great caution in using section 129(l) of HOEPA in the area of underwriting standards. MBA fears that promulgating rules under this authority to limit or restrict underwriting standards could have a detrimental and immediate impact on the cost and availability of residential mortgage credit across all market sectors. If the Board decides to issue rules under this authority, it should target only practices that are truly unfair and deceptive. As noted earlier, the liability exposure in combination with underwriting restrictions that expose lenders to liability could have dire consequences that would exacerbate the existing credit crunch for mortgage liquidity. For these reasons, MBA believes that regulation of underwriting standards should be very carefully construed and limited to regulatory guidance.

1. Should lenders be required to underwrite all loans to the fully indexed rate and fully amortizing payment?

The variety of mortgage products that currently exist have been instrumental in putting consumers in homes and offering them flexibility and choice. Through innovation, several new categories of borrowers have had the opportunity to buy a home, take advantage of terms that best fit their life situation and improve their credit. Adjustable rate mortgages (ARMs), in particular, play an important role in providing consumers flexibility.

Requiring that ARMs across all mortgage sectors be underwritten to the fully indexed and fully amortizing rate threatens their availability. It would roll back the clock to a time where mortgage product options were limited. In that era, it was difficult for credit impaired or cash-poor borrowers to qualify for mortgage loans. In addition, many borrowers whose personal circumstances make an ARM the better financial option would be foreclosed from the opportunity to save money. In addition, we fear that such overbroad standards would unnecessarily prevent creditworthy borrowers from gaining access to mortgage credit, creating a barrier to homeownership. Lenders would simply not make ARMs available because they would not offer the same value.

We also believe that the Statement and Guidance have gone a long way to ensure that nontraditional and certain ARM products are underwritten to the fully indexed rate and fully amortizing payment. MBA does not believe new rules should be issued expanding the scope of loans that would have to be underwritten in the same manner. The Statement and the Guidance have carefully identified a category of loans where this standard of underwriting is required and we believe going any further would be detrimental to the cost and availability of mortgage credit.[19]

Requiring all loans to be underwritten to the fully indexed and fully amortizing rate is inappropriate for many reasons:

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[19] If the Board decides to implement a fully indexed underwriting requirement beyond the market sectors and loans covered by the Statement and the Guidance, MBA urges it to incorporate the definition of "fully indexed rate" from the Guidance. The Guidance provides:

> The fully indexed rate equals the index rate prevailing at origination plus the margin that will apply after the expiration of an introductory interest rate. The index rate is a published interest rate to which the interest rate on an ARM is tied. Some commonly used indices include the 1-Year Constant Maturity Treasury Rate (CMT), the 6-Month London Interbank Offered Rate (LIBOR), the 11th District Cost of Funds (COFI), and the Moving Treasury Average (MTA), a 12-month moving average of the monthly average yields of U.S. Treasury securities adjusted to a constant maturity of one year. The margin is the number of percentage points a lender adds to the index value to calculate the ARM interest rate at each adjustment period. *In different interest rate scenarios, the fully indexed rate for an ARM loan based on a lagging index (e.g., MTA rate) may be significantly different from the rate on a comparable 30-year fixed-rate product. In these cases, a credible market rate should be used to qualify the borrower and determine repayment capacity.*[19]

Thus, in the Nontraditional Mortgage Guidance, the Agencies appropriately recognized that lenders should have flexibility in underwriting standards used to qualify borrowers. As the text italicized above makes clear, the Agencies correctly recognized that in many interest rate environments, the difference between an ARM's margin plus index and the rate of a 30-year fixed-rate loan can be substantial. Unless lenders are permitted to use a "credible market rate," when such substantial rate differences exist, many more consumers would qualify for a 30-year fixed-rate mortgage than could qualify for an ARM. Thus, the consumers could qualify for a loan with a higher monthly payment but not a loan with a lower monthly payment. Such results would seem unintended and certainly do not benefit consumers.

Accordingly, we would recommend that if the Board expands the requirement to underwrite to the fully indexed, fully amortized rate beyond the Statement and the Guidance, it should state that if a consumer has demonstrated an ability to service a long-term debt – such as by qualifying for a 30-year fixed-rate loan – the consumer should not be prevented from opting instead for another loan product that the consumer prefers, including hybrid ARM products that provide the benefit of lower monthly payments for an initial period.

First, this requirement likely would greatly increase foreclosure rates by preventing borrowers who have been making timely payments under ARM loans from refinancing. Requiring that loans be underwritten at the fully indexed rate will drastically reduce the maximum debt-to-income ratio for many products—likely to a level so low that many consumers who currently have subprime loans will be unable to qualify.

Second, prime, Alt. A and subprime ARMs can offer an effective form of financing for someone at a particular period in life or for someone who anticipates moving. A borrower may need a cash-out refinancing for a health emergency facing her or her family with every hope of getting through it. Of course things might not go her way and she could end up experiencing difficulties in paying the mortgage, but the vast majority of borrowers do well with these loans. Further, for military personal who move frequently, adjustable rate mortgages can offer an affordable means or the only means through which these individuals can become homeowners. Taking away this opportunity could have a long-lasting, negative impact on homeownership opportunities.

Third, as we believe the Board is aware, hybrid ARMs in the past frequently have been underwritten using flexible underwriting guidelines based on reasonable prepayment expectations, allowing many more borrowers to qualify for these loans. If ARMs and hybrid ARMs are required to be underwritten at the fully indexed rate, then we must face the fact that many borrowers will not qualify for mortgages to buy homes or to get needed credit. For many borrowers, the choice is not between an ARM and a fixed-rate mortgage to finance the property they want; it is an ARM or no mortgage at all.

Fourth, a requirement to underwrite to the fully indexed, fully amortized rate incorrectly assumes that a borrower's income will be the same throughout the loan, including when the loan adjusts to the fully indexed rate. Kristopher Gerardi and Paul S. Willen of the Federal Reserve Bank of Boston and Harvey S. Rosen of Princeton University recently released a study showing that borrowers frequently base credit decisions on future rather than present income, and that borrowers have been quite rational in making those decisions.[20] As Professor Rosen stated, "Our findings suggest that people make sensible housing decisions in that the size of the house they buy today relates to their future income, not just their current income and that innovations in mortgages over 30 years gave many people the opportunity to own a home that they would not have otherwise have, just because they didn't have enough assets in the bank at the moment they needed the house."[21] Professor Rosen further explains that requirements like underwriting to a fully indexed rate could harm the very people such requirements are intended to protect: "The main thing that innovations in the mortgage market have done over the past 30 years is to let in the excluded: the young, the discriminated against, the people without a lot of money in the bank to use for a down payment."[22] In reviewing

[20] Gerardi, Kristopher et al., *Do Households Benefit from Financial Deregulation and Innovation? The Case of the Mortgage Market*, NBER Working Paper No. W12967 (Mar. 2007), *available at* http://ssrn.com/abstract=971601.

[21] *Quoted in* Austan Goolsbee, *"Irresponsible" Mortgages Have Opened Doors to Many of the Excluded*, N.Y. TIMES, Mar. 29, 2007.

this study, Professor Goolsbee of the University of Chicago cautions "that Regulators should be mindful of the potential downside in tightening [underwriting requirements] too much."[23]

The proposal to require underwriting to the fully indexed rate and fully amortized payment would, in effect, require that lenders apply a "stress test" to each individual loan, rather than to their entire portfolio. Establishment of a "loan-level" stress test would be new and, if it became precedent, could drastically reduce credit availability to a very wide range of borrowers. Lenders can prudently make long-term fixed-rate loans, as they can prudently offer subprime mortgage products, because they have sophisticated models that allow them to manage their financial risk on a portfolio basis. Using these models, lenders can and do take into account the probability that the vast majority of loans will be paid off before the end of their terms. In subprime loans, as in other mortgage loans, borrowers have the option of paying off the loan at any time, and they do so for a variety of reasons, including sale of the residence, cashing-out equity, moving from a variable to a fixed-rate, or moving from a subprime to a prime loan.

MBA does not believe the foregoing standard should be applied beyond subprime hybrid ARMs and nontraditional products. Consistent with our earlier comments, we also do not believe any such standard should be applied to prime or Alt. A borrowers where more flexible underwriting standards match borrowers' behavior and risks and where there are no evident underwriting problems. We also recommend that any standard make clear that borrowers can also be qualified based on factors beyond PITI, such as the amount of down payment, rent payment history or other legitimate factors.

As noted above, MBA believes that underwriting standards should be treated under regulatory guidance. In this way, a lender has flexibility where situations demand it. We cannot underscore the need to carefully consider policy in this area since it goes to the very heart of the availability of innovative credit options. Should the Board issue any restrictive regulations, it should also clarify that consideration of future income potential in the underwriting process is not an unfair or deceptive act or practice.

2. Should there be a rebuttable presumption that a loan is unaffordable if the borrower's debt-to-income ratio exceeds 50 percent (at loan origination)?

No. Debt-to-income is only one factor in determining whether a borrower can repay a loan. Many borrowers with debt-to-income ratios greater than 50 percent have taken out loans that have performed well. The mortgage market is dynamic. If the 28/36 debt ratios that were the standard 10-15 years ago had become a hardwired legal standard, it would have prevented many prospective homeowners from entering the mortgage market. If the Board hardwires a rigid standard, it will certainly prevent creditworthy borrowers from qualifying for mortgage credit.

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[22] *Id.*

[23] *Id.*

In addition, this standard does not take into account the creditworthiness of borrowers whose income would likely increase after origination. For example, borrowers who buy a home during graduate studies often experience an increase in their income in the near future. A 50 percent debt-to-income standard at origination would prevent a lender from taking future income into account and could unnecessarily prevent that borrower from getting a mortgage.

Notably, limitations on what payment or rate is used in underwriting debt -to-income ratios will have different effects on different borrowers. For example, in some markets, if the debt-to-income ratio is a problem, the potential borrower can look for a less expensive house requiring a smaller loan. This is not an option, however, in high cost markets where borrowers may already reaching to buy the least expensive homes.

3. Are there specific consumer disclosures that would help address concerns about unaffordable loans?

MBA has a longstanding commitment to improving and simplifying the existing disclosure regime. We support clear disclosure of loan products, loan terms and the cost of mortgage credit. As discussed earlier in this letter, we support a uniform disclosure regime that includes improved disclosures where prepayment fees or stated-income or low-documentation loans are offered.

Improvements to the disclosure process would help consumers and reduce mortgage costs. The FTC recently released a staff report on the value of improving consumer mortgage disclosures. The study concluded that mortgage disclosure forms fail to convey key mortgage costs and terms to many consumers.[24] We understand the Board intends to review the disclosures that are under its jurisdiction, and we support those efforts. To that end, MBA recently unveiled a consumer guide, "The Simple Facts," that explains in clear and straightforward language mortgage product characteristics and the cost of credit. The Simple Facts describes the basics of loan terms and includes a link to a Web-based mortgage calculator that enables borrowers to easily compare mortgage options and consider what their payments under each product will be now and in the future. Both of these are available at www.homeloanlearningcenter.com, an MBA Web site intended to educate consumers about the basics of credit, finance and buying a home.

4. How would such provisions affect consumers and the type and terms of credit offered?

As indicated, we urge the Board to be extremely cautious in creating restrictions and limitations on underwriting standards. MBA is concerned that regulating underwriting standards under section 129(l) of HOEPA will take flexibility out of the equation and threaten the availability of credit, especially for products and loan terms for those

[24] "Improving Consumer Mortgage Disclosures," Bureau of Economics Staff Report, Federal Trade Commission, authored by James M. Lacko and Janis K. Pappalardo, (June 2007).

consumers who demand it. If underwriting standards are to be regulated, we strongly recommend that it be done through guidance that doesn't constrain flexibility.

Conclusion

MBA has long supported strong action against abusive actors in the marketplace. While MBA supports the Board's review of abuses in the mortgage market, we are concerned that extending overbroad standards under section 129(l) of HOEPA would give rise to serious litigation risk and exacerbate the current credit crunch in the capital markets. We would recommend that the Board utilize its authority under section 105(a) of TILA to require improved disclosures where that approach satisfies its concerns. Beyond that, we support the issuance of regulatory guidance where consumers benefit from lender innovation and flexibility. The market reacts to guidance as though it were a regulation.

We appreciate the opportunity to provide these comments. Please contact Mary Jo Sullivan, Senior Director of Government Affairs, at (202) 557-2859 if you have any questions.

Sincerely,

John Robbins, CMB
Chairman